



Minimise your intangible risks: evolving your approach to risk management

Accepted practice in corporate governance and risk management has traditionally been seeped in scientific and mechanistic management approaches. Compliance, regulation, risk and legislative frameworks are generally applied, analysed, audited and reported on to varying degrees of accuracy and certainty.

Unfortunately, all of these management mechanisms do not in themselves lead to effective governance, as evidenced by the multitude of corporate scandals and collapses, both pre and post GFC (think: Lehman Brothers, Storm Financial, HIH, Enron, Arthur Anderson, WorldCom etc, etc).

Overconfidence in the 'science' of risk management leads to faulty corporate governance

Andrew Cornell (AFR BOSS, 11 March, 2010) warns about "the danger of certainty in economic analysis" and its contribution to the current convulsions in financial systems.

"Reassured with answers rather than probabilities, with [belief in] specific outcomes rather than [the reality of] a chaos of possibilities, markets acted with irrational certainty. And went catastrophically awry."

The current scientific approach to risk management is necessary but insufficient to mitigate intangible risks to business success. Cornell goes further to assert that there is

now a shift in thinking and appreciation that the intangible qualities of 'culture' are critical to the issue of risk management and corporate governance.

"Corporate culture cannot bestow immunity, but where culture is strong, where governance standards are high, the dangers of rogue activity are lessened." he advises.

The rigour and robustness of the scientific approach also needs to be applied to the less tangible aspects of organisations to provide greater visibility and enable management of the unacceptable variation from the expected.

Compliance and regulation mechanisms used alone, without explicitly including the intangible aspects of ethics, psychology and political systems only serve to increase an organisation's systemic risk. This deficit in approach to appears to have been a major contributor to most of the recent corporate scandals and collapses.

This approach to risk management and governance is more 'art' than science.

The 'art' of risk management and corporate governance

The 'art' of risk management and governance is the capability of directors and executives to navigate and understand the highly complex and unpredictable set of human behaviours and interactions that is the modern organisation.



These intangible and more subtle aspects of the organisation, such as beliefs motivations and political dynamics, are difficult to measure, influence and describe, let alone govern effectively.

Performance management and assessment processes, culture and engagement surveys, leadership competency assessments and organisational development initiatives are designed to create visibility of these intangible aspects of organisations. But they often fall short by not accounting for the hidden, unspoken and un-self-aware aspects of human beings and the social systems in which they operate (e.g. the difference between what is said and what is meant at many family dinner tables).

These subtle aspects of people and systems, the psychology and ethics of individuals and their interface with the cultural/ political system, are the greatest determinants of what really happens within organisations. This is often despite the systems and processes that the leaders of an organisation put in place to direct and control the behaviour of their employees.

‘That which is out of awareness, is in control’.

This means that the subtle aspects of people and organisations are the most risky of all.

Most of the corporate collapses and scandals that have occurred lately were not the result of inadequate risk management, poorly crafted strategy or incompetence in knowledge or skills.

In almost every case it is becoming apparent that the causes lay in the psychology, ethics and beliefs of individuals and in the political system and power plays in the organisational culture that rewarded short term value extraction over long term, sustainable value creation.

To create value and act effectively in a post-GFC world, directors and executives must balance both ‘science’ and ‘art’ as they experiment with and evolve approaches to

risk management and corporate governance. They must take responsibility for assessing the obvious and the subtle, the asset values and debt ratios as well as the ethics, power and political systems of the people tasked to perform the activities of the organisation.

A blend of art and science has always been recognised as the foundation of a sound education...

The only hope that leaders have for the ‘scientific’ behaviours and processes being effective is if they attend to the subtle ‘art’ of risk management and governance of the intangibles as well.

The way forward requires leaders to navigate the interconnected, complex systems in which they operate and leverage the value of the human, structural and relational capital that sits within.

Minimising your intangible risks builds value in the organisation; Evolving your risk management approach will maintain and enhance investor confidence and market relevance (investors report they would pay a 20% premium on companies deemed to have a robust risk approach). Proactively managing intangible risk gives greater transparency to the downside while equipping the organisation to capitalise on the upside.

Minimising your intangible risks creates competitive advantage ensuring reputation, brand and market value. It delivers increased organisational agility and speed to move and meet challenges through access to more valuable and relevant business intelligence.

To do anything but this surely is the definition of ‘risky business’.